

**Review of Compliance with the Internal Revenue Code**  
**for Retirement Benefits**  
**Report No. 98-11, April 2, 1998**

**Background**

The Railroad Retirement Solvency Act of 1983 made all railroad retirement annuities taxable beginning with the 1984 tax year. Prior to this legislation, only supplemental annuities had been subject to federal income tax. The RRB is required to follow the IRC when reporting for benefits paid to beneficiaries. The IRC requires the RRB to:

- Report benefits paid and Social Security Equivalent Benefits (SSEB) repaid during the tax year;
- Provide annuitants with an annual statement of benefits;
- Report information from the annuitants' annual tax statements to the Internal Revenue Service;
- Withhold taxes in the case of citizens, resident aliens and nonresident aliens; and
- Deposit such taxes in an authorized financial institution.

The RRB issues the annual statement of benefits to each annuitant on or before January 31 of the year following the close of the tax year. This statement documents the total amount of benefits paid, a breakdown of the benefit components, the SSEB portion of benefits repaid and the total amount of United States federal taxes withheld.

A railroad retirement benefit payment may include the following annuity components depending on age and eligibility requirements: Tier I, Tier II, vested dual benefits and supplemental annuity benefits. Tier I is based on railroad retirement credits and any social security credits employees have acquired. Tier II is based on railroad retirement credits only.

The SSEB portion of Tier I is equivalent to the amount that the Social Security Administration would pay if railroad service were covered under the Social Security Act. The SSEB portion of Tier I is treated as social security benefits for federal income tax purposes.

The Non-SSEB is the amount of Tier I that exceeds the SSEB portion of Tier I. The Non-SSEB portion of Tier I and the Tier II are treated like contributory pensions for federal income tax purposes.

The vested dual benefit is the component of a regular railroad retirement annuity that is

payable in addition to the Tier I and Tier II to individuals who were eligible for both railroad and social security benefits prior to 1975.

A supplemental annuity is an annuity in addition to the regular annuity payable to railroad retirement employees who have a current connection with the railroad industry. These employees have completed at least 25 years of creditable railroad service and retired before their closing date. The closing date for most employees is the last day of the month following the month in which age 65 is attained. Both vested dual benefits and supplemental annuities are fully taxable for federal tax purposes and are treated like a non-contributory pension.

The RRB's Office of Programs issues tax statements to those beneficiaries who receive railroad retirement annuities during the tax year. These beneficiaries include retired railroad employees, spouses, spouses with a child in care, divorced spouses, and survivors of deceased railroad employees.

The Office of Programs uses the Tax Accounting System to calculate federal income tax withholding amounts and to maintain tax information for beneficiaries. The agency's automated checkwriting system deducts the withholding amounts from the annuity payments. The RRB's automated systems determine when a tax statement is required and produces tax statements and notices.

The RRB has entered into a contract with LaserTech of Madison, Wisconsin for the printing of annual tax statements. Annually, the Office of Programs performs quality control testing of LaserTech's printing.

The RRB's 1997 - 2002 Strategic Plan provides that relevant, timely, and accurate information which is easy to understand will be provided to beneficiaries. One RRB performance goal is to maintain the combined balance of unprocessed record corrections and cases requiring review for corrected tax statements below the end-of-year normal level of 1200 items. The combined balance for 1996 showed 525 items.

### **Objective, Scope, and Methodology**

The objective of the review was to determine if the RRB was in compliance with the IRC for railroad retirement benefits for 1996. We accomplished the objective by: (1) reviewing applicable laws and regulations; (2) reviewing applicable RRB procedures and controls; (3) reviewing the Risk Assessment Report for the Tax Reporting, and Tax Withholding and Deposits assessable units; (4) interviewing RRB personnel; (5) selecting a random sample of 200 tax records to determine if tax statements contained the proper information; (6) determining whether tax statements were issued timely; and (7) comparing tax withholding amounts to amounts deposited with the United States Department of the Treasury (Treasury).

The field work was performed at the RRB's headquarters in Chicago, Illinois during the period December 1997 through March 1998. The review was conducted in accordance with generally accepted government auditing standards. However, the OIG performed only a limited review of controls. The OIG did not perform testing of the completeness of the Tax Accounting System database. The OIG also did not test tax statement information for accuracy.

## **Results of Review**

Based on our review, the RRB generally complied with the IRC for railroad retirement benefits for 1996. The agency released annual statements of benefits to all beneficiaries by January 31. Federal income taxes were withheld by the Office of Programs and deposited with Treasury.

The review showed that the Office of Programs has not documented procedures for quality assurance testing of LaserTech's printing.

The results of the review follow.

## **Reporting of Benefits**

The RRB reports benefits paid through numerous automated systems and applications. In addition, the RRB's system of internal controls ensures that tax statement information that the agency releases to beneficiaries and the Internal Revenue Service is timely.

The RRB's Publication TB-85, "Information About the Taxation of Railroad Retirement Annuities," provides that annual statements are due by January 31 of the year following the close of the tax year for citizens and resident aliens and by March 15 for nonresident aliens. However, the Taxation Operations Manual procedures and the RRB's Risk Assessment Report only mention a January 31 due date for tax statements.

Section 6050G(b)(2) of the IRC provides the general instructions that annual statements of benefits paid be released to all annuitants by January 31. The Internal Revenue Service Instructions for Form 1042-S, which covers nonresident aliens, provides that tax statements to nonresident aliens must be furnished by March 15.

The Office of Programs' management is aware of the differing due dates for tax statements - January 31 for citizens and resident aliens, and March 15 for nonresident aliens. Nonresident aliens represented less than one percent of all 1996 tax statements issued. The Office of Programs generally issues tax statements to all annuitants by the earlier due date, January 31.

The review showed that the RRB released all 1996 tax statements for beneficiaries by January 31, 1997. In addition, the RRB released the 1997 tax statements by January 31, 1998, with the exception of a few manually handled cases.

## **Random Sample**

The RRB issued 820,177 tax statements to beneficiaries for the 1996 tax year. We selected a random sample of 100 citizen/resident alien and 100 nonresident alien records for review. Because the Tax Accounting System can produce a duplicate of the original tax statement issued by LaserTech, we compared the tax information from the detail/subsidiary tax screen to the duplicate statements.

The review of the random sample cases disclosed the following:

1. The amount of taxes withheld on the duplicate statements and the detail records were identical;
2. The tax breakdown (SSEB, Non-SSEB, etc.) was properly stated on the duplicate tax statement as compared with the detail record; and,
3. The tax statement for death cases reflected the proper benefits and taxes withheld.

The LaserTech contract provides that the agency may review a preproduction sample of up to 200 tax statements from the final product. The Office of Programs' review consists of comparing tax statements to RRB records for consistency and verifying that appropriate mailing information is correctly completed. The Office of Programs' review also ensures that the number of statements released match the RRB's record count.

The OIG's review of the results of the Office of Programs quality control review for the preproduction sample did not disclose any problems.

The Office of Programs has not formally documented the procedures for quality control testing of LaserTech's preproduction sample. Management relies on the knowledge of the individuals who perform the function.

Sound management practices require formal procedures and/or standards to accomplish program goals and provide management with available guidelines. Unforeseen management/personnel changes in the Office of Programs could disrupt activities related to quality assurance testing of LaserTech's printing. As a result, all tax statements could potentially be released untimely or released without the appropriate mailing information.

## **Recommendation**

We recommend that the Office of Programs document the procedures for quality assurance testing of LaserTech's preproduction tax statements.

## **Management's Response**

The Director of Programs has agreed with this recommendation and will document the

procedures by June 1, 1998.

### **Federal Tax Withholding and Deposits**

The RRB applies federal income tax withholding to railroad retirement annuity payments based on the citizenship and residency, marital status, and tax withholding allowances. We compared the 1996 income taxes withheld to the amount of taxes deposited at Treasury.

The review showed that controls over withholding income taxes are adequate to ensure that the amount of tax withholding deposited to Treasury is accurate and complete. For the 1996 tax year, the Office of Programs reported the total amount of taxes withheld and deposited. The Office of Programs also requested tax withholding amounts from the Internal Revenue Service as a credit for excess deposits which generally result from death cases.

The IRC requires that the RRB make electronic media and tax returns of Railroad Retirement Act tax deposit information to the Treasury. For the 1996 tax year, these reports and statements of information were submitted to Treasury as required.

The IRC also requires that the RRB timely deposit tax withholding amounts in an authorized financial institution. Taxes withheld from annuitants' benefits are kept in the RRB trust funds. Those funds remain in the trust funds until the money is transferred electronically to the Treasury. The review showed that adequate controls are in place to ensure that the deposits are transferred timely to Treasury.